New Financial Supervisory Structure in Germany

Background and Main Features
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European Framework for Financial Supervision

- Maastricht Treaty of 1992 establishes European Union (EU) and stipulates basic rules within EU
- Article 105 of Maastricht Treaty: Banking Supervision remains in national responsibility of member states (same applies to Insurance Supervision)

European Framework for Financial Supervision

- Banking Supervision assymetric to Monetary Policy
- Maastricht Treaty gives Power of Monetary Policy to European Central Bank (ECB) in Frankfurt
- National Central Banks including Deutsche Bundesbank no longer directly involved in Monetary Policy decision making process
- Only President of Bundesbank represented in ECB Council

European Framework for Financial Supervision

- Diversified picture of organization of Banking Supervision in EU
- Ranging from Central Banks being completely in charge of Banking Supervision to UK´s Single Regulator Concept with Independent Financial Services Agency being responsible i.a. for banking, securities and insurance supervision

Former System of Financial Supervision in Germany

- Banking Supervision: BAKred, Federal Banking Supervisory Office, in Bonn, about 650 people, and co-operation with Bundesbank
- Insurance Supervision: BAV, Federal Insurance Supervisory Office, in Bonn, about 350 people
- Market Supervision: BAWe, Federal Securities Office, in Frankfurt, about 150 people

Options for change discussed in Germany 1999 and 2000

- Combine Banking Supervisory functions of BAKred and units involved with banking supervision in Bundebank (around 600) under the roof of Bundesbank
- Create new and independent Supervisory Authority in charge of banking, insurance and securities supervision
- Various mixtures of the above

January 25, 2001: Decision for an Integrated Supervisor

- Ministry of Finance (MoF) Press Conference by Minister Hans Eichel:
- BAKred, BAV and BAWe will be merged into one independent Federal Agency combining old offices´ duties and staff under one umbrella
- Name of the new agency (announced later) : German Financial Supervisory Authority (BAFin)

January 25, 2001: Decision for an Integrated Supervisor II

- BAFin as an integrated regulator supervises German financial market as a whole
- Offices did not relocate from Bonn or Frankfurt; BAFin retains a double seat
- Bundebank involvement in on-going day-to-day Banking Supervision continue; details are spelled out in the new Article 7 of the Banking Act

Reasons for BAFin

- Institutional make-up of supervisory framework has to reflect realities in the financial markets in order to generate proactive supervision:
- Banks, insurance companies and securities firms competing in the same markets, for the same customers, with similar or identical lines of products, via the same distribution channels
- Convergence of products particularly advanced in mortgage loans, derivative trading, asset management and the combination of investment funds for capital formation

Reasons for BAFin II

- Weakening of entry barries into the financial markets encreased blurring of business lines, reform of German pension system from 2002 on a further catalyst for convergence of banking and insurance products
- Similar convergence between product vendors and distribution channels
- In essence: vanishing cross-sectoral boundaries and traditional distinctions which used to apply across types of firms, types of product and types of distribution channels
- Organization and management of financial institutions have comparable structures

Reasons for BAFin III

- Due to credit and market risk transfers, risk assessment becomes more cross-sectoral in nature
- Overall level playing field issue: same business, same risks, same rules
- Huge Financial Conglomerates: takeover of Dresdner Bank by Allianz and increased participation by Munich Re in HypoVereinsbank, two biggest financial conglomerates in the EU are German (Nos. 3 and 4 worldwide)
- Overall, increased number of mergers and acquisitions between/by bank and securities firms, purchases of fund managers by banks and insurance companies

Reasons for BAFin IV

- Consumer and investor protection strengthened by one supervisor for financial market as a whole
- More flexible payment structure in the future (e.g. Basel II) by taking supervision out of the Federal Budget (100% financed by supervised entities)
- Better representation of German interests internationally by co-ordination of BAFin´s cross-sectoral activities in international committees and groups

Reasons for BAFin V

- General rationale for a single regulator:
- Synergies of scale and scope in larger organisation
- More efficient supervision by avoiding duplications between sectoral supervisors
- Better internal resource allocation
- More effective and efficient conflict resolution between different objectives of supervision, especially prudential/ solvency and consumer protection
- Reduction of indirect supervisory costs

Implementation

- Draft bill was passed by Cabinet in fall of 2001, approved by Bundestag early 2002, not vetoed by Bundesrat in late March 2002, Bill enacted into law by April 30, 2002
- Political decision making process was difficult for several reasons and took more time than expected
- BAFin not operative as of January 1, 2002, as planned in 2001; now, BAFin operating since May 1, 2002
- Budget for 2002 approved by August 30, 2002, budget for 2003 will be approved by end of October: 160 new staff by the end of 2002 and an extimated 220 for 2003

BAFin´s New Structure

President
Deputy President
Cross Sectoral Issues
Personnel, Budget, IT

Director
Banking Supervision
Division Heads
Dept./Section Heads

Director
Insurance Supervision
Division Heads
Dept./Section Heads

Director
Securities Supervision
Division Heads
Dept./Section Heads

Cross-sectoral Departments

- Financial Markets and International Co-ordination (Financial Conglomerates, Capital Market and Financial Instruments, Retail Markets and Products, Financial Research and Stability, Bilateral Contacts with foreign supervisors, International Co-ordination, Germany as a Financial Center)
- Consumer and Investor Protection, Pension Schemes and cross-sectoral legal matters
- Integrity of the Financial System (Anto-money laundering, fight against terrorism, enforcement against financial businesses without licence, on-site inspections)

Responsibilities of BAFin and Bundesbank in Banking Supervision

- Section 7 Banking Act was amended to specify co-operation betweeen BAFin and Bundesbank in more detail
- BAFin has sole responsible for supervisory measures and decision making, in particular issuing general instructions and administrative acts including ordering and commissioning audits and on-site examinations (immediate corrective action)

Responsibilities in Banking Supervision II

- BAFin issues (in consultation with Bundesbank) guidelines for the on-going day-to-day banking supervision
- BAFin and Bundesbank co-operate in day-to-day supervision
- Free flow of information (as before) and more co-operation as regards common data base and IT

Responsibilities in Banking Supervision III

- Memorandum of Understanding between BAFin and Bundesbank will clarify exact division of work in day-to-day supervision
- Negotiations still on-going about details, but close to agreement
- In on-going supervision, shift to more on-site examinations by BAFin and Bundesbank

Modified Single Regulator

- „Modified“ compared to UK´s FSA example because central bank continues to be involved in on-going banking supervision
- „single regulator“ because of integrated supervision of financial market as a whole
- concept tries to combine advantages of single regulator with active role of central bank in banking supervision in order to maximize positive effects for financial stability